

**Remarks to City Council to Explain Council Bill 2010-037 (Deposit of
Telecommunication Lawsuit Settlement Funds and Proposal to Consider
Allocating toward City's AFC Liability)**

January 25, 2010

This bill is similar to the other bills that have directed the deposit of telecommunication lawsuit settlement funds into the Police-Fire Pension Fund. However, this bill also includes a provision that will allow the new Citizens' Sales Tax Oversight Committee to review the impact of the City's 2006 decision to close the Tier I retirement plan on the Additional Funding Contribution, or AFC, paid by our police and fire employees.

This is a complex proposal. If you are not immersed in studying this issue, it can be difficult to understand at first. Because of that complexity, I want to provide a rather extensive explanation of what is being proposed. I ask for your indulgence.

First and foremost, let me explain that this proposal would result in 100% -- every penny -- of the most recent telecommunications lawsuit settlement being deposited into the Police-Fire Pension Fund. Council made that commitment before the November 3rd election -- this proposal keeps that commitment.

However, as we deposit the proceeds from this last settlement into the pension fund, we have a one-time opportunity. All we are asking for at this time is approval to let a citizens' group study this proposal and make a recommendation to Council as to whether it makes sense.

The complexity of this proposal requires that I provide some background and history. It may be most clear if I present this information in chronological order.

In the late 1990s, the police and fire employee associations petitioned the City for a benefit that they -- the employees -- would fully fund. The associations were proposing to increase the retirement multiplier -- the number used to multiply the final average salary and years of service to determine the retirement amount -- from 2.5 to 2.8. They were proposing that this 0.3 addition to the multiplier would be fully funded by the employees themselves via an Additional Funding Contribution, or AFC. The proposal was that this benefit would, in essence, be cost neutral to the City.

Now the employees were already contributing 8.5% of their payroll toward their retirement fund. As a reminder, police and fire employees are not eligible to receive Social Security benefits for their work at the City. The AFC, once determined by an actuary, would be added to the 8.5% contribution to fully fund this benefit. When negotiated, the assumption was that the employee group (now called Tier I) would remain open in the future. This is a key point to keep in mind. The initial AFC was calculated at that time to be 2.14% on top of the 8.5% base.

Fast forward to May 2000. The City and employee associations formally agreed to the addition of 0.3 to the multiplier and the City Council approved it. This new benefit created an immediate liability, and both the employee associations and the City recognized that fact. That immediate liability was created because not every current employee at that time, in the year 2000, would contribute enough AFC to pay for the benefit they would receive during their lifetime. For example, a police officer or firefighter eligible for retirement could have retired shortly after this benefit was agreed to, provided only a few months of AFC contributions, but then retired and received the additional 0.3 multiplier for their entire retirement. Obviously, there is no way the few months of AFC contributions by this employee would come close to covering the total cost of this added benefit during their retirement. Thus, there was an immediate liability created when this deal was struck. Both parties of the agreement – the City and the employee associations – were aware of this liability at the time the agreement was struck in 2000, and the associations agreed to assume that liability going forward. But the assumption was that the Tier I plan would remain open and that the immediately assumed liability would be covered by the AFC contributions from both current and new employees in the future. That assumption – that there would be new hires in the future to contribute toward covering this liability – is key to this discussion.

Fast forward to 2004. In 2004, the pension fund actuary re-calculated the AFC for this benefit as 2.85%. That meant that all employee payroll contributions increased to 11.35%. As before, this additional contribution was calculated knowing that employees receive their contributions back (the principal, but not the interest) when they resign or retire.

Fast forward again to 2006. In 2006, everything changed.

In 2006, the City decided to close the Tier I plan to new hires and create the Tier II retirement plan for those police and fire employees hired after July 1, 2006. The employee associations opposed this action, but I do believe this was the appropriate action to help “stop the bleeding” of the pension fund. Whether you agree with that action or not, the fact is, it happened. But as I stated in the memo I sent to you last Friday, this action had unforeseen repercussions.

By closing the Tier I plan to new hires in 2006, the “open” plan suddenly became a “closed” plan.

Fast forward again to 2009. Since the AFC is currently re-calculated every five years, it was due to be re-calculated in 2009. And it was. In fact, it was re-calculated using two different sets of assumptions. The first time, the pension plan’s actuary calculated the AFC in the same manner it had been calculated in 2004 – with the assumption that the plan was still “open.” In that manner, the AFC was calculated to increase from the current 2.85% to 4.75% -- an increase of 1.9%. The second time the actuary re-calculated the AFC, he assumed the plan was closed – which it is – and would have an ever-shrinking pool of Tier I employees to contribute their AFC into the fund to cover

their liability – which will occur. That time, the AFC was calculated to increase from the current 2.85% to 7.52% -- an increase of 4.67%.

✓ The difference between these two calculations, which is 2.77%, constitutes the cost attributable to closing the Tier I plan to new hires and shortening the amortization period. This is the component of the AFC that I believe is the City's obligation due to closing the plan in 2006.

Also during 2009, the actuary calculated the amount of the total unfunded liability associated with the AFC to be \$9.2 million. To clarify, the \$9.2 million liability is part of the approximately \$200 million total underfunding of the Police-Fire Pension Fund – it is not an additional amount. In a minute, I will discuss the portion of this \$9.2 million liability that I believe the City owns.

So that brings us to today.

If you agree with me that the City has an obligation to cover 2.77% of the AFC increase, then we have two options for covering that obligation – we can pay it annually for approximately 20 years, or we can pay it in a lump sum. Allow me to give you more information about each option.

Option A . . .

If we agree that the City owns 2.77% of the AFC increase and we elect to cover this obligation over multiple years, then the City's annual contribution to the Police-Fire Pension Fund could increase from the promised 35% to 37.7% for the next 20 years. For our upcoming fiscal year, that means this would cost the City an additional \$475,000. To tell you the truth, I'm not sure where we would come up with an additional half-a-million dollars in next year's budget.

Option B . . .

If we agree that the City owns 2.77% of the AFC increase, then the City could optionally elect to pay off our obligation in a lump sum by allocating \$5.6 million of the \$7.45 million lawsuit proceeds. This would accomplish a number of things. First and foremost, it would completely pay off the City's portion of the 2006 action that closed the Tier I plan. I cannot foresee any time in the City's future when we would have funds available to completely payoff our debt. This is a unique opportunity. However, there are also a few other benefits to this course. By paying off the City's obligation in a lump-sum, these funds will earn interest. As a result of the City fully paying its obligation and the compounded investment returns over time, this should result in a more manageable AFC adjustment in the future. This may prevent the AFC contribution from employees becoming overwhelming in future years. This, too, is a positive result. Again, as stated earlier, the entire telecommunication lawsuit settlement amount would be deposited into the Police-Fire Pension Fund and becomes part of the investment proceeds.

How did we determine how much of the \$9.2 million unfunded liability is the responsibility of the City? In May 2000, there were 403 active police officers and firefighters. Since that time, 130 have retired and 273 remain as active employees. The prior service time that was accrued as of May 2000 by those now-retired and still-active employees was more heavily weighted towards those that have already retired and who are no longer contributing toward this benefit. This constitutes approximately 61% of the liability. There are many feasible ways to calculate and determine the City's obligation within the \$9.2 million liability. We are proposing that the City's lump-sum contribution cover the liability associated with those employees who were employed in May 2000, when the benefit deal was struck, and have since retired. Currently employed police and fire staff would be expected to cover their liability going forward – both the cost of their own benefit and the remaining 39% of the liability, which represents their own past service cost.

The \$9.2 million unfunded liability associated with the AFC is part of the approximately \$200 million underfunding of the pension plan. This is not a liability above and beyond the \$200 million shortfall – it is part of it. That is important to understand. We're talking about allocating funds to resolve the City's portion of that \$9.2 million liability.

So we must ask ourselves . . .

- Does the City "own" this obligation for 2.77% of the AFC increase due to closing the Tier I plan back in 2006?
- If the answer is "yes," should the City pay off this obligation over the next 20 years via an increase in our annual contribution from 35% to 37.7%, or does it make sense to pay it in a lump sum during a once-in-a-lifetime opportunity when there are telecommunication lawsuit settlement funds that the City has been fighting to receive over the past decade on behalf of our taxpayers?

Due to the complexity of this proposal, we are not asking you to vote in two weeks whether or not to accept this proposal. We are only asking to keep the door open, and asking that a group of citizens make a recommendation to you regarding this proposal. Specifically, we are asking that the soon-to-be-formed Citizens' Sales Tax Oversight Committee study this issue and advise you as to whether or not this proposal is in the City's best interest.

We are currently in meet-and-confer negotiations with the police and fire associations regarding the AFC contribution increase, and your decision as to whether this proposal will be considered will obviously have an effect on those discussions.

Thank you for indulging me in this rather lengthy explanation. I will be glad to try to answer any questions you may have.